

PERAC AUDIT REPORT



Newton Contributory Retirement System

JAN. 1, 2001 - DEC. 31, 2004 / PERAC 04: 11-068-30



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PERAC

COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

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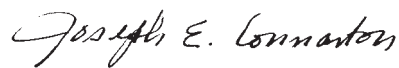
September 22, 2006

The Public Employee Retirement Administration Commission has completed an examination of the Newton Retirement System pursuant to G.L. c. 32, § 21. The examination covered the period from January 1, 2001 to December 31, 2004. This audit was conducted in accordance with the accounting and management standards established by the Public Employee Retirement Administration Commission in regulation 840 CMR 25.00. Additionally, all supplementary regulations approved by PERAC and on file at PERAC are listed in this report.

In our opinion the financial records are being maintained and the management functions are being performed in conformity with the standards established by the Public Employee Retirement Administration Commission.

In closing, I acknowledge the work of examiners James Sweeney and James Ryan who conducted this examination and express appreciation to the Board of Retirement and staff for their courtesy and cooperation.

Sincerely,



Joseph E. Connarton
Executive Director



Newton Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

1. Cash Reconciliation:

The City Treasurer is not performing a complete reconciliation, including identification of stale checks, of the retirement system's cash account on a monthly basis as obligated as custodian of the system's funds.

Recommendation: Pursuant to G.L. c 32, § 23(2)(a) the City Treasurer shall be the custodian of the city retirement fund. As custodian of the retirement fund, the Treasurer should perform a monthly reconciliation of all retirement system cash accounts. This process is necessary to maintain proper internal control of the retirement system by segregating reconciliatory duties. The Treasurer must forward appropriate documents (including bank statements, reconciliations, and outstanding check lists) to the Retirement Board on a monthly basis. The Retirement Board should then reconcile to the General Ledger and any checks outstanding for more than six months should be researched by the Board, so that the proper voiding and recording of these items can be completed. The Board must ensure that the Treasurer fulfills his/her obligation as custodian of the fund.

Board Response:

The deficiencies in the timely identification and resolution of outstanding checks has been resolved by opening a separate bank account for all retirement system disbursements. Retirement System checks were previously disbursed from the City's vendor and payroll accounts. This arrangement made it difficult to identify outstanding retirement system checks for appropriate follow up by the Retirement Board.

2. Membership:

PERAC auditors sampled members' deduction rates to determine that correct percentages are being withheld, and that the additional 2% deduction is withheld from those members who make over \$30,000 and were hired after January 1, 1979. The additional 2% deduction was not withheld for members receiving separate checks for other regular income such as clothing allowances.

Recommendation: The Board must comply with G.L. c. 32, § 22(1)(b), and PERAC Memo #43/1999, which directs that the additional 2% deductions be withheld on total regular compensation over \$30,000 on a individual pay-period basis.

Board Response:

The City's Information Technology Department has requested that the City's software vendor provide a modification to existing payroll applications software to allow for proper deductions to be taken on compensation received in separate pay checks. The Newton Retirement Board is expected to fund the cost of the payroll software modification.

Newton Retirement System

EXPLANATION OF FINDINGS AND RECOMMENDATIONS (CONT'D)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

Administrative Observation:

The City of Newton has a disaster recovery plan that addresses procedures for software and financial data recovery. However, the plan does not address the backup hardware and location needed to re-process the data lost in the event of a disaster.

Recommendation: The current disaster recovery plan should be modified to include the hardware and location required to bring financial data to current status and timely processing of retirement checks.

Board Response:

The Newton Retirement Board has previously requested that the Mayor and Board of Aldermen provide funding to the City's Information Technology Department in order to fund necessary back up hardware. The City's independent auditors and Comptroller have also reported this deficiency in internal control to the Mayor's Office and Board of Aldermen.

Final Determination

PERAC auditors will follow-up in six (6) months to ensure that the appropriate actions have been taken regarding all findings.

Newton Retirement System

STATEMENT OF LEDGER ASSETS AND LIABILITIES

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2001
AND ENDING DECEMBER 31, 2004**

ASSETS	FOR THE PERIOD ENDING DECEMBER 31,			
	2004	2003	2002	2001
Cash	\$2,421,150	\$4,999,172	\$10,282,162	(\$141,387)
Short Term Investments	0	0	0	
Fixed Income Securities (at book value)	0	0	0	408,337
Equities	23,870,106	0	0	0
Pooled Short Term Funds	1,818			0
Pooled Domestic Equity Funds	103,141,871	110,600,121	83,849,736	106,713,455
Pooled International Equity Funds	25,770,102	21,910,167	16,908,868	23,264,390
Pooled Global Equity Funds	0	0	0	0
Pooled Domestic Fixed Income Funds	69,494,246	69,186,035	65,541,412	1,948,524
Pooled International Fixed Income Funds	0	0	0	0
Pooled Global Fixed Income Funds	0	0	0	71,833,065
Pooled Alternative Investment Funds	0	0	0	0
Pooled Real Estate Funds	14,116,873	13,213,567	14,125,637	10,118,804
Pooled Domestic Balanced Funds	0	0	0	0
Pooled International Balanced Funds	0	0	0	0
PRIT Cash Fund	0	0	0	0
PRIT Core Fund	0	0	0	0
Interest Due and Accrued	0	0	0	0
Accounts Receivable	781,743	650,735	48,024	4,174,380
Accounts Payable	(138,191)	(109,809)	(8,682)	(7,500)
TOTAL	<u>\$239,459,719</u>	<u>\$220,449,988</u>	<u>\$190,747,158</u>	<u>\$218,312,067</u>
FUND BALANCES				
Annuity Savings Fund	\$58,563,181	\$56,724,495	\$55,032,226	\$53,266,681
Annuity Reserve Fund	25,323,645	24,172,766	22,428,956	21,125,289
Pension Fund	155,516,802	139,515,056	113,261,764	143,891,331
Military Service Fund	56,092	37,671	24,211	28,767
Expense Fund	0	0	0	0
Pension Reserve Fund	0	0	0	0
TOTAL	<u>\$239,459,719</u>	<u>\$220,449,988</u>	<u>\$190,747,158</u>	<u>\$218,312,067</u>

Newton Retirement System

STATEMENT OF CHANGES IN FUND BALANCES

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2001
AND ENDING DECEMBER 31, 2004**

	Annuity Savings Fund	Annuity Reserve Fund	Pension Fund	Military Service Fund	Expense Fund	Total All Funds
Beginning Balance (2001)	\$51,469,451	\$19,531,615	\$164,657,065	\$28,231	\$0	\$235,686,362
Receipts	6,184,376	604,273	(4,439,842)	536	1,118,986	3,468,329
Interfund Transfers	(3,396,077)	3,398,284	(2,207)	0	0	0
Disbursements	(991,070)	(2,408,883)	(16,323,686)	0	(1,118,986)	(20,842,624)
Ending Balance (2001)	53,266,681	21,125,289	143,891,331	28,767	0	218,312,067
Receipts	6,255,347	642,277	(12,972,290)	358	1,136,266	(4,938,043)
Interfund Transfers	(3,409,143)	3,430,547	(16,490)	(4,914)	0	0
Disbursements	(1,080,657)	(2,769,157)	(17,640,786)	0	(1,136,266)	(22,626,866)
Ending Balance (2002)	55,032,227	22,428,956	113,261,764	24,211	0	190,747,159
Receipts	6,566,509	687,340	44,834,094	259	1,021,420	53,109,622
Interfund Transfers	(3,841,161)	3,834,349	(6,389)	13,201	0	0
Disbursements	(1,033,079)	(2,777,880)	(18,574,413)	0	(1,021,420)	(23,406,792)
Ending Balance (2003)	56,724,496	24,172,766	139,515,056	37,671	0	220,449,989
Receipts	6,581,629	736,891	35,906,326	222	941,708	44,166,776
Interfund Transfers	(3,437,990)	3,440,995	(21,205)	18,199		0
Disbursements	(1,304,953)	(3,027,008)	(19,883,376)	0	(941,708)	(25,157,045)
Ending Balance (2004)	<u>\$58,563,182</u>	<u>\$25,323,645</u>	<u>\$155,516,802</u>	<u>\$56,092</u>	<u>\$0</u>	<u>\$239,459,720</u>

Newton Retirement System

STATEMENT OF INCOME

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2001
AND ENDING DECEMBER 31, 2004**

	FOR THE PERIOD ENDING DECEMBER 31,			
	2004	2003	2002	2001
Annuity Savings Fund:				
Members Deductions	\$5,655,477	\$5,460,562	\$5,165,181	\$4,745,995
Transfers from other Systems	457,011	458,786	308,806	421,487
Member Make Up Payments and Redeposits	88,505	50,592	70,768	80,409
Member Payments from Rollovers	55,563	72,146	0	0
Invest Inc Credited to Member Accts	<u>325,072</u>	<u>524,424</u>	<u>710,590</u>	<u>936,485</u>
Sub Total	<u>6,581,629</u>	<u>6,566,509</u>	<u>6,255,347</u>	<u>6,184,376</u>
Annuity Reserve Fund:				
Invest Inc Credited Annuity Reserve Fund	<u>736,891</u>	<u>687,340</u>	<u>642,277</u>	<u>604,273</u>
Pension Fund:				
3 (8) (c) Reimbursements from Other Systems	236,745	205,417	169,273	162,630
Received from Commonwealth for COLA and Survivor Benefits	1,313,510	1,177,150	1,258,280	1,390,472
Pension Fund Appropriation	9,740,337	8,120,500	7,427,936	6,867,272
Federal Grant Reimbursement	195,942	177,855	122,866	130,209
Pension Reserve Appropriation	0	0	0	0
Interest Not Refunded	8,402	8,222	12,206	14,637
Excess Investment Income	<u>24,411,389</u>	<u>35,144,951</u>	<u>(21,962,851)</u>	<u>(13,005,062)</u>
Sub Total	<u>35,906,326</u>	<u>44,834,094</u>	<u>(12,972,290)</u>	<u>(4,439,842)</u>
Military Service Fund:				
Contribution Received from Municipality on Account of Military Service	0	0	0	0
Invest Inc Credited Military Service Fund	<u>222</u>	<u>259</u>	<u>358</u>	<u>536</u>
Sub Total	<u>222</u>	<u>259</u>	<u>358</u>	<u>536</u>
Expense Fund:				
Expense Fund Appropriation	194,733	190,069	189,593	177,577
Invest Inc Credited to Expense Fund	<u>746,975</u>	<u>831,351</u>	<u>946,673</u>	<u>941,409</u>
Sub Total	<u>941,708</u>	<u>1,021,420</u>	<u>1,136,266</u>	<u>1,118,986</u>
TOTAL RECEIPTS	<u>\$44,166,776</u>	<u>\$53,109,622</u>	<u>(\$4,938,043)</u>	<u>\$3,468,329</u>

Newton Retirement System

STATEMENT OF DISBURSEMENTS

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2001
AND ENDING DECEMBER 31, 2004**

	FOR THE PERIOD ENDING DECEMBER 31,			
	2004	2003	2002	2001
Annuity Savings Fund:				
Refunds to Members	\$567,485	\$556,107	\$594,371	\$542,869
Transfers to other Systems	<u>737,468</u>	<u>476,971</u>	<u>486,286</u>	<u>448,201</u>
Sub Total	<u>1,304,953</u>	<u>1,033,079</u>	<u>1,080,657</u>	<u>991,070</u>
Annuity Reserve Fund:				
Annuities Paid	2,974,271	2,747,590	2,568,764	2,401,212
Option B Refunds	<u>52,736</u>	<u>30,290</u>	<u>200,393</u>	<u>7,671</u>
Sub Total	<u>3,027,008</u>	<u>2,777,880</u>	<u>2,769,157</u>	<u>2,408,883</u>
Pension Fund:				
Pensions Paid				
Regular Pension Payments	12,970,799	11,950,713	11,230,865	10,300,223
Survivorship Payments	1,545,440	1,490,474	1,517,092	1,327,240
Ordinary Disability Payments	174,913	170,776	165,716	135,706
Accidental Disability Payments	3,435,068	3,211,393	3,003,708	2,955,226
Accidental Death Payments	1,258,979	1,277,040	1,252,586	1,166,260
Section 101 Benefits	134,012	145,133	141,840	122,067
3 (8) (c) Reimbursements to Other Systems	364,164	328,883	328,979	316,962
State Reimbursable COLA's Paid	0	0	0	0
Sub Total	<u>19,883,376</u>	<u>18,574,413</u>	<u>17,640,786</u>	<u>16,323,686</u>
Military Service Fund:				
Return to Municipality for Members Who Withdrew Their Funds	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Expense Fund:				
Board Member Stipend	15,000	14,064	15,000	15,000
Salaries	140,193	139,229	138,753	126,635
Legal Expenses	218	3,035	0	0
Medical Expenses	0	0	0	0
Travel Expenses	7,267	5,775	10,303	6,943
Administrative Expenses	28,322	32,853	48,595	36,485
Furniture and Equipment	189	0	4,379	289
Management Fees	621,228	731,216	830,555	853,552
Custodial Fees	39,054	24,605	21,428	22,083
Consultant Fees	67,000	64,000	61,000	58,000
Fiduciary Insurance	14,922	6,163	5,292	0
Service Contracts	<u>8,317</u>	<u>480</u>	<u>960</u>	<u>0</u>
Sub Total	<u>941,708</u>	<u>1,021,420</u>	<u>1,136,266</u>	<u>1,118,986</u>
TOTAL DISBURSEMENTS	<u>\$25,157,045</u>	<u>\$23,406,792</u>	<u>\$22,626,866</u>	<u>\$20,842,624</u>

Newton Retirement System

INVESTMENT INCOME

**FOR THE FOUR YEAR PERIOD BEGINNING JANUARY 1, 2001
AND ENDING DECEMBER 31, 2004**

	FOR THE PERIOD ENDING DECEMBER 31,			
	2004	2003	2002	2001
Investment Income Received From:				
Cash	\$35,438	\$78,078	\$40,154	\$71,944
Short Term Investments	0	0	0	0
Fixed Income	0	0	43,244	30,548
Equities	72,030	2,589	5,799	72,140
Pooled or Mutual Funds	5,573,678	4,018,675	5,864,913	6,641,509
Commission Recapture	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
TOTAL INVESTMENT INCOME	<u>5,681,146</u>	<u>4,099,342</u>	<u>5,954,110</u>	<u>6,816,141</u>
Plus:				
Realized Gains	35,513,145	6,832,544	6,991,118	10,546,177
Unrealized Gains	33,800,066	51,248,399	23,471,494	34,137,140
Interest Due and Accrued on Fixed Income Securities - Current Year	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	<u>69,313,211</u>	<u>58,080,943</u>	<u>30,462,613</u>	<u>44,683,318</u>
Less:				
Paid Accrued Interest on Fixed Inc Securities	0	0	0	0
Realized Loss	(1,952,726)	(7,551,009)	(11,966,990)	(3,712,763)
Unrealized Loss	(46,821,081)	(17,440,950)	(44,112,687)	(58,309,055)
Interest Due and Accrued on Fixed Income Securities - Prior Year	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Sub Total	<u>(48,773,807)</u>	<u>(24,991,959)</u>	<u>(56,079,677)</u>	<u>(62,021,817)</u>
NET INVESTMENT INCOME	<u>26,220,550</u>	<u>37,188,325</u>	<u>(19,662,954)</u>	<u>(10,522,359)</u>
Income Required:				
Annuity Savings Fund	325,072	524,424	710,589	936,485
Annuity Reserve Fund	736,891	687,340	642,277	604,273
Military Service Fund	222	259	358	536
Expense Fund	<u>746,975</u>	<u>831,351</u>	<u>946,673</u>	<u>941,409</u>
TOTAL INCOME REQUIRED	<u>1,809,161</u>	<u>2,043,374</u>	<u>2,299,897</u>	<u>2,482,703</u>
Net Investment Income	<u>26,220,550</u>	<u>37,188,325</u>	<u>(19,662,954)</u>	<u>(10,522,359)</u>
Less: Total Income Required	<u>1,809,161</u>	<u>2,043,374</u>	<u>2,299,897</u>	<u>2,482,703</u>
EXCESS INCOME TO THE PENSION RESERVE FUND	<u>\$24,411,389</u>	<u>\$35,144,951</u>	<u>(\$21,962,851)</u>	<u>(\$13,005,061)</u>

Newton Retirement System

STATEMENT OF ALLOCATION OF INVESTMENTS OWNED

(percentages by category)

FOR THE PERIOD ENDING DECEMBER 31, 2004

	MARKET VALUE	PERCENTAGE OF TOTAL ASSETS	PERCENTAGE ALLOWED*
Cash	\$2,421,150	1.01%	100
Short Term	0	0.00%	100
Fixed Income	0	0.00%	30 - 80
Equities	23,870,106	10.00%	70
Pooled Short Term Funds	1,818	0.00%	
Pooled Domestic Equity Funds	103,141,871	43.19%	
Pooled International Equity Funds	25,770,102	10.79%	13
Pooled Global Equity Funds	0	0.00%	
Pooled Domestic Fixed Income Funds	69,494,246	29.10%	
Pooled International Fixed Income Funds	0	0.00%	5
Pooled Global Fixed Income Funds	0	0.00%	
Pooled Alternative Investment Funds	0	0.00%	
Pooled Real Estate Funds	14,116,873	5.91%	10
Pooled Domestic Balanced Funds	0	0.00%	
Pooled International Balanced Funds	0	0.00%	
PRIT Cash Fund	0	0.00%	
PRIT Core Fund	0	0.00%	100
GRAND TOTALS	<u>\$238,816,167</u>	<u>100.00%</u>	

For the year ending December 31, 2004, the rate of return for the investments of the Newton Retirement System was 12.66%. For the five-year period ending December 31, 2004, the rate of return for the investments of the Newton Retirement System averaged 3.69%. For the twenty-year period ending December 31, 2004, since PERAC began evaluating the returns of the retirement systems, the rate of return of the investments of the Newton Retirement System was 10.23%.

Newton Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

The Newton Retirement System submitted the following supplementary investment regulations, which were approved by PERAC on :

November 18, 1985

20.03(1) Equity investments shall not exceed 70% of the total book value of the portfolio at the time of purchase.

20.03(2) At least 30% but no more than 80% of the total portfolio valued at market shall consist of fixed income investments with maturity of more than one year.

February 10, 1987

20.06(8) Sales of fixed income investments with maturities exceeding one year shall not exceed 200% of the market value of all fixed income obligations in any twelve month period excluding cash and short term obligations.

20.07(6) Sales of equity investments shall not exceed 200% of the average market value of all equity holdings in any twelve-month period.

August 24, 1989

20.08(e) Enrollment in the Securities Lending Program offered by Boston Safe Deposit & Trust Company.

May 23, 1990

20.03(1) Equity investments shall not exceed 70% of the portfolio valued at market, including international equities which shall not exceed 13% of the portfolio valued at market.

20.04(1) United States based corporations and equities of foreign corporations.

20.07(5) Equity investments shall be made only in securities listed on a United States stock exchange, traded over the counter in the United States, or listed and traded on a foreign exchange.

20.07(6) Sales of equity investments shall not exceed 100% of the average market value of all equity holdings in any twelve-month period.

January 3, 1992

16.02(3) The board may incur expenses for investment advice or management of the funds of the system by a qualified investment manager and the board may incur expenses for consulting services. Such expenses may be charged against earned income from investments provided that the total of such expenses shall not exceed in any one year:

(a) 1% of the value of the fund for the first \$5 million; and

(b) 0.5% of the value of the fund in excess of \$5 million.

16.02(4) The board may employ a custodian bank and may charge such expenses against earned income from investments provided that such expenses shall not exceed in any one-year .08% of the value of the fund.

Newton Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS (CONTINUED)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

January 21, 1992

20.07(6) Sales of equity investments shall not exceed 150% of the average market value of all equity holdings in any twelve-month period.

18.02(4) **Rate of Return.** The rate of return shall be at least 1% greater than the composite return of an index comprised of 40% of the S&P 500 Stock Index and 60% of the Shearson Lehman Government/Corporate Bond Index.

16.02(4) The board may employ a custodian bank and as of January 1, 1991 may charge such expenses against earned income from investments provided that such expenses shall not exceed in any one-year .08% of the value of the fund.

March 8, 1995

20.03(2) At least 40% but no more than 80% of the total portfolio valued at market shall consist of fixed income investments with a maturity of more than one year, including international fixed income investments which shall not exceed 5% of the portfolio valued at market.

20.04(6) The board may invest in obligations issued by foreign corporations and in obligations issued and guaranteed by foreign governments.

20.06(2) Bonds shall have a minimum quality rating of Baa or equivalent as rated by one or more recognized bond rating services, however, 5% of the market value of fixed income investments may be invested in bonds with a minimum quality rating of CCC as rated by the Standard and Poors Corporate and Municipal Rating Service.

20.06(4) Fixed income holdings which are downgraded by one or more recognized rating services to below a Baa or equivalent rating must be sold within a reasonable period of time not to exceed one year, however, 5% of the market value of fixed income investments may be invested in bonds with a minimum quality rating of CCC as rated by the Standard and Poors Corporate and Municipal Rating Service.

October 2, 1995

840 CMR 21:00: Prohibited Investments

(3) Future Contracts other than as follows:

(a) Currency Futures, Calls and Forward Contracts may be written against securities in the international portfolio by an investment advisor registered under the Investment Advisors Act of 1940 and who has been granted a waiver from PERAC for international investments.

(b) Currency Futures, Calls and Forward Contracts may be written against securities in the international portfolio to a maximum of fifty percent (50%) of the international portfolio's non-dollar holdings at market value. Speculative currency positions unrelated to underlying portfolio holdings are strictly prohibited.

Newton Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS (CONTINUED)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

September 12, 1996

20.06(10) Private Placement securities falling under the governance of Rule 144A may be purchased up to 5% of the market value of the fixed income portfolio at the time of purchase. These Rule 144A Private Placements shall be considered to be corporate bonds and, as such governed by the guideline constraints pertaining to corporate bonds including those stated in the Statement of Objectives (Form 18-1) and PERAC Regulations 840 CMR.

November 22, 1996

20.06(2) Bonds shall have a minimum quality rating of Baa or equivalent as rated by one or more recognized bond rating services, however, 5% of the total investment portfolio may be invested in Bonds with a minimum quality rating of CCC as rated by the Standard and Poors Corporate and Municipal Rating Service.

20.06(4) Fixed income holdings which are downgraded by one or more recognized rating services to below a Baa or equivalent rating must be sold within a reasonable period of time not to exceed one year, however, 5% of the total investment portfolio may be invested in bonds with a minimum quality rating of CCC as rated by the Standard & Poors and Municipal Rating Service.

20.03(2) At least 30% but no more than 80% of the total portfolio valued at market shall consist of fixed income investments with a maturity of more than one year, including international fixed income investments which shall not exceed 5% of the portfolio valued at market.

April 30, 1998

20.07(9) Commingled real estate shall not exceed 10% of the total book value at the time of purchase provided that:

- (a) the retirement board does not participate in the selection of personnel responsible for making real estate investments and should this be required, prior to any participation by the board, the board shall consult with PERAC to determine the appropriate course of action;
- (b) such personnel retain authority in the decision making process, and
- (c) should an investment in real estate result in direct ownership of real estate or mortgage indebtedness, such shall be permitted only until such time as divestiture is prudent.

April 25, 2000

16.08 In accordance with PERAC Investment Guideline 99-2, the Newton Retirement System may invest in Freedom Equity Style Fund. This change represents no basic difference in overall asset allocation investment style, or in the universe of securities eligible for investment. By going from a separately managed account to a commingled fund that seeks to replicate the value component of the S&P 500 Index, the system will fulfill its investment strategy with a lower cost structure.

Newton Retirement System

SUPPLEMENTARY INVESTMENT REGULATIONS (CONTINUED)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

February 22, 2001

16.08 In accordance with PERAC Investment Guideline 99-2, the Newton Retirement System may modify the structure of two of its domestic equity mandates from separately managed accounts to commingled funds. It is investing in the Freedom Capital Large Cap Value Fund and the David L. Babson Small Capitalization Value Fund. Both funds represent a continuation of the investment strategies followed by the respective prior separate accounts.

September 30, 2002

16.08 Pursuant to PERAC Investment Guideline 99-2, the Newton Retirement Board is authorized to modify their fixed income mandate with Wellington Management Company from “Core Plus” to “Core”. Wellington has been managing fixed income assets of the board since 1995.

Newton Retirement System

NOTES TO FINANCIAL STATEMENTS

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

NOTE 1 - THE SYSTEM

The plan is a contributory defined benefit plan covering all Newton Retirement System member unit employees deemed eligible by the retirement board, with the exception of school department employees who serve in a teaching capacity. The Teachers' Retirement Board administers the pensions of such school employees.

Instituted in 1937, the System is a member of the Massachusetts Contributory Retirement System and is governed by Chapter 32 of the Massachusetts General Laws. Membership in the plan is mandatory immediately upon the commencement of employment for all permanent, full-time employees.

The system provides for retirement allowance benefits up to a maximum of 80% of a member's highest three year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, level of compensation, and group classification.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65 (for certain hazardous duty and public safety positions, normal retirement is at age 55).

A retirement allowance consists of two parts: an annuity and a pension. A member's accumulated total deductions and a portion of the interest they generate constitute the annuity. The differential between the total retirement benefit and the annuity is the pension. The average retirement benefit is approximately 75 - 85% pension and 15 - 25% annuity.

Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Members joining the retirement system after January 1, 1979 must contribute an additional 2% on regular compensation earned at a rate in excess of \$30,000. The percentage rate is keyed to the date upon which an employee's membership commences. These deductions are deposited in the Annuity Savings Fund and earn interest at a rate determined by the Executive Director of PERAC according to statute. When a member's retirement becomes effective, his/her deductions and related interest are transferred to the Annuity Reserve Fund. Any cost-of-living adjustment granted between 1981 and 1997 and any increase in other benefits imposed by state law during that period are borne by the state.

The pension portion of any retirement benefit is paid from the Pension Fund of the System. The governmental unit employing the member must annually appropriate and contribute the amount of current year pension payments as indicated on the most recent funding schedule as approved by PERAC's Actuary. Until recently, retirement systems were paying only the actual retirement

Newton Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

benefits that were due each year. Systems had no statutory authorization to put aside any money for the future benefits of employees who are now working. Large unfunded liabilities resulted from operating upon this pay-as-you-go basis. In 1977, legislation authorized local governments to appropriate funds to meet future pension obligations.

In 1983, additional legislation was passed requiring the transfer of investment earnings (in excess of the amount credited to member accounts) into the Pension Reserve Fund. These initiatives have significantly reduced the rate of growth of the retirement systems' unfunded liabilities, and in some systems have actually eliminated such liability.

Administrative expenses are funded through investment income of the system.

Members who become permanently and totally disabled for further duty may be eligible to receive a disability retirement allowance. The amount of benefits to be received in such cases is dependent upon several factors including: whether or not the disability is work related, the member's age, years of creditable service, level of compensation, veteran's status, and group classification.

Employees who resign from service and who are not eligible to receive a retirement allowance or are under the age of 55 are entitled to request a refund of their accumulated total deductions. In addition, depending upon the number of years of creditable service, such employees are entitled to receive either zero (0%) percent, fifty (50%) percent, or one hundred (100%) percent of the regular interest which has accrued upon those deductions. Survivor benefits are extended to eligible beneficiaries of members whose death occurs prior to or following retirement.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The accounting records of the System are maintained on a calendar year basis in accordance with the standards and procedures established by the Executive Director of Public Employee Retirement Administration Commission.

The Annuity Savings Fund is the fund in which members' contributions are deposited. Active members contribute either 5, 7, 8, or 9% of their gross regular compensation. Voluntary contributions, re-deposits, and transfers to and from other systems, are also accounted for in this fund. Members' contributions to the fund earn interest at a rate determined by PERAC. Interest for some members who withdraw with less than ten years of service is transferred to the Pension Reserve Fund. Upon retirement, members' contributions and interest are transferred to the Annuity Reserve Fund. Dormant account balances must be transferred to the Pension Reserve Fund after a period of ten years of inactivity.

Newton Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

The Annuity Reserve Fund is the fund to which a member's account is transferred upon retirement from the Annuity Savings Fund and Special Military Service Credit Fund. The annuity portion of the retirement allowance is paid from this fund. Interest is credited monthly to this fund at the rate of 3% annually on the previous month's balance.

The Special Military Service Credit Fund contains contributions and interest for members while on a military leave for service in the Armed Forces who will receive creditable service for the period of that leave.

The Expense Fund contains amounts transferred from investment income for the purposes of administering the retirement system.

The Pension Fund contains the amounts appropriated by the governmental units as established by PERAC to pay the pension portion of each retirement allowance.

The Pension Reserve Fund contains amounts appropriated by the governmental units for the purposes of funding future retirement benefits. Any profit or loss realized on the sale or maturity of any investment or on the unrealized gain of a market valued investment as of the valuation date is credited to the Pension Reserve Fund. Additionally, any investment income in excess of the amount required to credit interest to the Annuity Savings Fund, Annuity Reserve Fund, and Special Military Service Credit Fund is credited to this Reserve account.

The Investment Income Account is credited with all income derived from interest and dividends of invested funds. At year-end the interest credited to the Annuity Savings Fund, Annuity Reserve Fund, Expense Fund, and Special Military Service Credit Fund is distributed from this account and the remaining balance is transferred to the Pension Reserve Fund.

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS

The Newton Retirement System submitted the following supplementary membership regulations, which were approved by PERAC on:

December 24, 1984

- Regularly employed part-time employees with 20 hours or more must join the retirement system.
- Buy-Back payments must be paid in \$200 installments or more.
- Accidental disability applicants must be present when their application is presented to the board, unless a medical reason exists that prevents them from being present, and they must also submit an accident report or reports.

Newton Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS (Continued)

MEMBERSHIP

Part time, provisional, temporary or intermittent employees who are regularly employed by the City of Newton or Newton Public Schools for an average of a minimum of 20 hours per week are eligible for membership in the retirement system.

There shall be three designated categories of employees for the City of Newton and Newton Public Schools:

1. Employees within category one shall be comprised of those persons who are permanent and regularly employed for a minimum average of 37.5 hours per week, full time status.
2. Employees within category two shall be comprised of those persons who have only been employed as part time, provisional, temporary or intermittent employees, and who therefore work less than 37.5 hours per week , but at least 20 hours per week.
3. Employees within category three shall be comprised of those persons who have worked both full time (37.5 hours per week) and part time (less than 37.5 hours per week but at least 20 hours per week) in their years of employment.

CREDITABLE SERVICE

Employees within category one shall be granted creditable service equal to 12 months for each year of employment.

Employees within category two shall be granted creditable service equal to 12 months for each year of employment if and only if part time employment equals the total number of hours per week prescribed by the City of Newton or Newton Public Schools for that job title or position.

Employees within category three shall be granted creditable service equal to 12 months for each year of full time employment of 37.5 hours per week, and a pro rated period of years or fractions thereof equal to the percentage that their average actual hours worked per week bears to the average full time employment of 37.5 hours per week multiplied by the number of part time years of employment.

Newton Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

NOTE 3 - SUPPLEMENTARY MEMBERSHIP REGULATIONS (Continued)

Employees of the City of Newton or the Newton Public Schools who are presently employed for less than an average of 20 hours per week and who have been previously accepted as members of the retirement system may retain their status as members in the system. For such persons, if their entire employment continues to be at less than an average of twenty hours per week, they shall be granted creditable service equal to 12 months for each year of part time employment if and only if their part time employment equals the total number of hours per week prescribed by the City of Newton or Newton Public Schools for that job title or position, as prescribed for category two employees above. For such persons, if they at any time accept employment of at least an average of 20 hours per week, then they shall be granted creditable service for such period prorated for the percentage that these actual work hours of at least an average of 20 hours per week bear to full time status of 37.5 hours per week. For the prior period of employment at less than an average of 20 hours per week, they shall be granted creditable service of a maximum of 6 months for each actual 12 month period of said part time employment.

Notwithstanding the above, those persons who as of May 12, 1987 are employed by the Newton Police Department as both (1) permanent traffic supervisors with permanent school crossing posts and (2) parking control officers (Meter Maids) shall receive creditable service as follows, given their membership in the Newton Retirement System.

Since employment as a permanent traffic supervisor is a pre-condition to appointment as a parking control officer, these persons shall receive 12 months creditable service for each year of prior permanent employment as a traffic supervisor alone, although the hours worked may have been less than 20 hours per week. Said persons shall also receive 12 months creditable service for each year of permanent employment as both traffic supervisor and parking control officer. In all cases, the part time employment for each job title must equal the total number of hours per week prescribed by the City of Newton for the job titles of traffic supervisor and parking control officer.

April 4, 2001

Only the City of Newton employees and members of the Newton Retirement System are eligible to buy back creditable service for Newton CETA employment.

October 14, 2003

Pursuant to the authority vested in the Commission under G.L. c. 7, § 50, the Board's supplementary rule regarding Authorization for Travel and Travel Related Expenses is approved.

Newton Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

NOTE 5 - ACTUARIAL VALUATION AND ASSUMPTIONS

The most recent actuarial valuation of the System was prepared by Mellon Consultants, Inc as of January 1, 2005.

The actuarial liability for active members was	\$161,860,643
The actuarial liability for retired members was	<u>199,219,693</u>
The total actuarial liability was	361,080,336
System assets as of that date were (actuarial value)	<u>244,265,934</u>
The unfunded actuarial liability was	<u>\$116,814,402</u>
 The ratio of system's assets to total actuarial liability was	 67.6%
As of that date the total covered employee payroll was	69,701,972

The normal cost for employees on that date was 7.90% of payroll

The normal cost for the employer was 3.27% of payroll

The principal actuarial assumptions used in the valuation are as follows:

Investment Return: 8.00% per annum
Rate of Salary Increase: Varies by group and year

GASB STATEMENT NO. 25, DISCLOSURE INFORMATION AS OF JANUARY 1, 2005

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Cov. Payroll ((b-a)/c)
1/1/2001	\$219,102,000	\$268,660,000	\$49,558,000	81.6%	\$60,769,000	81.6%
1/1/2002	\$228,239,000	\$306,123,000	\$77,884,000	74.6%	\$61,438,000	126.8%
1/1/2003	\$227,126,000	\$338,172,000	\$111,046,000	67.2%	\$64,636,000	171.8%
1/1/2004	\$233,888,000	\$350,688,000	\$116,800,000	66.7%	\$68,327,000	170.9%
1/1/2005	\$244,265,934	\$361,080,336	\$116,814,402	67.6%	\$69,701,972	167.6%

Newton Retirement System

NOTES TO FINANCIAL STATEMENTS (Continued)

FOR THE FOUR YEAR PERIOD ENDING DECEMBER 31, 2004

NOTE 6 - MEMBERSHIP EXHIBIT

Retirement in Past Years	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Superannuation	19	29	39	34	37	35	48	46	49	42
Ordinary Disability	0	1	1	1	1	1	0	2	0	0
Accidental Disability	3	14	2	2	3	1	7	4	8	4
Total Retirements	22	44	42	37	41	37	55	52	57	46
Total Retirees, Beneficiaries and Survivors	1,256	1,263	1,271	1,267	1,279	1,260	1,272	1,272	1,292	1,304
Total Active Members	1,488	1,487	1,541	1,586	1,500	1,721	1,641	1,706	1,743	1,763
Pension Payments										
Superannuation	\$7,809,314	\$7,761,960	\$8,692,878	\$8,632,691	\$9,000,093	\$9,638,881	10,300,223	11,230,865	11,950,713	\$12,970,799
Survivor/Beneficiary Payments	964,604	997,078	1,077,204	1,129,242	1,234,250	1,285,014	1,327,240	1,517,092	1,490,474	1,545,440
Ordinary Disability	152,825	158,480	161,932	149,807	140,304	132,180	135,706	165,716	170,776	174,913
Accidental Disability	2,173,284	2,322,817	2,604,642	2,633,353	2,671,114	2,780,622	2,955,226	3,003,708	3,211,393	3,435,068
Other	<u>1,413,972</u>	<u>1,525,203</u>	<u>1,541,660</u>	<u>1,552,661</u>	<u>1,561,948</u>	<u>1,551,680</u>	<u>1,605,290</u>	<u>1,723,405</u>	1,751,056	<u>1,757,156</u>
Total Payments for Year	<u>\$12,513,999</u>	<u>\$12,765,538</u>	<u>\$14,078,316</u>	<u>\$14,097,754</u>	<u>\$14,607,709</u>	<u>\$15,388,377</u>	<u>\$16,323,686</u>	<u>\$17,640,786</u>	<u>\$18,574,413</u>	<u>\$19,883,376</u>

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